CHAPTER VI

APPLICATION OF RESULTS: FURTHER INVESTIGATIONS

The direct use of the results obtained is restricted. They indicate the relative strength of the various causes of fluctuations in investment activity discussed in Chapters III to V. In addition, something can be deduced about the chief proximate causes of turning-points in investment activity. Thus, the crisis of 1883 and the revival in 1887 in the United Kingdom may be ascribed to changes in profits (cf. graph III. 4), while the revival of 1875 would seem to be primarily explained by the fall in iron prices. To give another example, the proximate causes of the well-known building boom after 1933 in the United Kingdom would appear to be the fall in interest rates and building costs and the rise in real income (cf. graph IV. 4). In some cases, conclusions about policy may be drawn. The reduction of long-term interest rate necessary to raise the volume of investment by a given percentage may be estimated in a few of our cases with some certainty. Thus, it would seem that for the United States in the period 1919-1932 a reduction of this rate by 1% might have led, after about half a year or so, to an increase in investment activity of about 5% of the average level.

Many questions, however, still remain unanswered. This is partly due to the degree of uncertainty in a number of results found, which can be reduced only if better statistics and more precise theories are available.

But more important is the fact that, in this pamphlet—which is primarily intended to demonstrate a method—the argument ends with the influence of profits, interest rates, etc., on the volume of investment.

The economist and the statesman may be anxious to know what in turn influences profits, and how these influences have been changed, or could be changed, by policy. This problem can also be studied
by means of the method described here, if that method is applied
to a larger number of inter-relations between economic variates.

In addition to the equation explaining investment fluctuations,
others explaining profits, prices of investment goods, interest rates
and so on, will then have to be established. The total number of
such equations should be equal to the number of variates necessary
to describe adequately the business-cycle mechanism. The sum
of these relations may be called a complete system. Such a
complete system is required to draw conclusions of the nature
indicated above.

A first attempt in this direction, covering the United States after
the war, will be published shortly as the second volume of this
series. An explanation will there be given of profits as the
difference between (i) total receipts of all enterprises, public
authorities, etc., included, and (ii) total costs.

Taking the country as a whole, and regarding it as a "closed
economy", all costs that consist in payments from one enterprise
to another cancel out. Total receipts may thus be taken as the
total value of consumers' goods and services produced (U), plus the
total value of investment goods and services sold by their pro-
ducers (V); the cost items to be deducted are:

Wages $L_w$ and salaries $L_s$;
Corporation managers' salaries $L_m$;
Rent payments $K_r$;
Interest payments $K_i$;
Depreciation allowances $N$.

Calling the amount of profits $Z$, we therefore get:

$$Z = U + V - (L_w - L_s + L_m + K_r + K_i + N),$$

and we may test this equation from the facts. On the basis of
this relation, an observed fall in profits may now be found to be
due to, e.g., a fall in $U$, total consumption. The causation of the
fall in this variate must then, in turn, be investigated, and so on.

It follows that full use of any relation can only be made after a
complete system has been established. Some of the most important
applications of the results of the present study can therefore only
be stated when the work for the next volume has been completed.